



UNITED STATES OF AMERICA
DEPARTMENT OF TRANSPORTATION
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1999 U.S.-ITALY COMBINATION
SERVICE CASE

Docket OST-98-4854

ORDER TO SHOW CAUSE

SUMMARY

By this order, we tentatively select Delta Air Lines, Inc., to operate seven weekly frequencies in the Atlanta, Georgia-Rome, Italy, market beginning April 1, 1999, and tentatively select US Airways, Inc., for backup authority.

BACKGROUND

On November 11, 1998, representatives of the United States and Italy initialed, *ad referendum*, a Protocol to the U.S.-Italy Air Transport Services Agreement. The Protocol establishes an open-skies aviation environment between the United States and Italy for future effectiveness, subject to certain specified conditions subsequent. Pending the effectiveness of the Protocol, the two sides agreed to expand services in the market by permitting airlines of each country to operate a total of seven additional weekly combination service frequencies between any point or points in the United States and any point or points in Italy. The new service could begin as early as April 1, 1999.

By Notice dated November 13, 1998, the Department solicited applications from U.S. carriers interested in using the available frequencies. American Airlines, Inc., Delta, Tower Air, Inc., and US Airways filed applications. By Order 98-12-3, December 3, 1998, the Department instituted the *1999 U.S.-Italy Combination Service Case*, Docket OST-98-4854, and consolidated the applications of the four carriers into that proceeding.¹ We analyzed the applications before us under traditional carrier selection procedures. The order established a procedural schedule for the submission of direct and rebuttal exhibits and briefs. The order also stated that our principal objective is to choose the carrier/gateway that would maximize the public benefits that could result from an award in this proceeding. Order 98-12-3, p.3.

¹ Tower subsequently filed a request to withdraw its application, which we will grant. See Appendix A for a brief summary of the remaining applicants' proposals.

EVIDENTIARY SUBMISSIONS

American proposes to operate daily nonstop service in the Chicago-Rome market; Delta proposes daily nonstop service in the Atlanta-Rome market; and US Airways proposes daily nonstop service in the Philadelphia-Milan market.

Direct and rebuttal exhibits and briefs were filed by American, Delta, US Airways, and also by the City of Chicago (in support of American's proposal), the City of Philadelphia, Division of Aviation (in support of US Airways' proposal), and the Georgia and Atlanta Parties (in support of Delta's proposal).

American argues that neither of the other two applicants should be accorded priority over American's proposal to restore nonstop flights in the Chicago-Rome market. In this regard, American states that Chicago recently lost its only nonstop service to Rome when Alitalia removed its long-standing service as part of a strategy to concentrate most of its international flights at its new Milan hub. American argues that the Chicago-Rome market is one of the largest U.S.-Italy markets—larger than either Atlanta-Rome or Philadelphia-Milan—and has a long-established history of supporting nonstop flights. American also argues that Chicago is one of the country's leading connecting hubs, and with its new Chicago-Rome service, American would provide on-line connections for passengers from dozens of behind cities and the first on-line nonstop-to-nonstop service to Rome operated by a U.S. airline from 31 U.S. cities. With respect to the other applicants' proposals, American argues that Milan is already well-served from multiple U.S. gateways on the east coast and that Delta, which operates to both Rome and Milan from its New York (JFK) gateway, already serves 17 of the top 24 U.S.-Rome markets with less circuitry via JFK than at its proposed Atlanta gateway, and has authority to provide unrestricted service from New York (JFK) and several other gateways.

The City of Chicago supports American's proposal, arguing that the Chicago-Rome local O&D market is larger than the local O&D market of either Atlanta-Rome or Philadelphia-Milan and that American's proposed Chicago-Rome service will benefit a larger number of behind-gateway passengers than the service proposals of the other applicants.

Delta argues that only its selection would create a new U.S. gateway to Italy, thus, meeting the Department's stated principle objective of maximizing the public benefits that will result from award of authority in this case. In addition, Delta argues that it would establish a new U.S.-flag gateway in an unserved region of the country, thereby remedying the Italy service gap in the Southeast and that it would operate the largest aircraft, offering the greatest capacity in the market. Delta further argues that it would use the strength of its large Atlanta hub to provide the most benefits to U.S.-Italy passengers across the nation, and that this would promote intergateway competition to a greater extent than the other applicants' proposals. Finally, Delta argues that neither of the other applicants' proposals would offer as many public benefits as Delta's proposal. Specifically, Delta argues that Chicago already has two daily nonstop flights to Italy and that American's plan to add a third daily nonstop flight would not cure the imbalance in the geographic distribution of U.S. gateways, and that US Airways' proposal would benefit the fewest local passengers and the fewest connecting passengers.

The Georgia and Atlanta parties support Delta's proposal, arguing that although the southern tier of the U.S. generates about 21 percent of the U.S.-Italy traffic, none of the five points that are currently gateways to Italy (Chicago, Newark, New York (JFK), Philadelphia, and Washington) are located in that region and that the selection of Delta's Atlanta proposal would remedy the imbalance in the geographic distribution of gateways. They also argue that Atlanta should receive its first nonstop U.S.-Italy service before Philadelphia receives its second such service and Chicago receives its third such service.

US Airways argues that this case should be decided based upon market structure issues. In this regard, US Airways argues that only its service proposal would create a competitive market structure and increase the level of competition in the relevant markets, which US Airways argues are the U.S.-Italy, U.S.-Milan, and U.S.-Europe markets. US Airways argues that in each of these markets there is a disadvantage in terms of service opportunities compared to selection of the other applicants—either in terms of direct service by those carriers in the relevant markets or through their alliances with foreign carriers—and that US Airways' selection in this case would provide significant new service options to the traveling public and would enhance competition with the addition of Philadelphia-Milan authority. US-T-2 and US Airways' Brief at 12. US Airways also maintains that an award to Delta would not enhance competition in the relevant markets because Delta currently operates nonstop service to both Rome and Milan from New York (JFK) and provides convenient on-line connections to from both Atlanta and Orlando and also because Delta is a mega-alliance carrier. US-T-1 at 9-11. Similarly, US Airways argues that an award to American also would not enhance competition in the relevant markets because American, like Delta, is strong in the North Atlantic market and is a global network carrier.

The City of Philadelphia supports US Airways' application, arguing that Philadelphia offers the greatest public benefits as the recipient of new U.S.-Italy service because Philadelphia has a greater concentration of Italian-Americans than either of the other two potential gateways. Philadelphia also argues Milan, not Rome, is the Italian gateway most in need of new U.S. carrier service and would enhance the U.S.-flag carrier market position to counter Alitalia's recent shift of the majority of its U.S.-Italy service from Rome to Milan.

DECISION

This proceeding stems from the efforts of the governments of the United States and Italy to create new opportunities for service in their civil aviation market. For many years, just two U.S. airlines could be designated to provide scheduled passenger service under our aviation agreement with Italy. Both airlines operated most of their service from the New York, JFK Airport gateway. Our 1990 aviation agreement with Italy provided for additional U.S. airline designations. We used those new opportunities to create new gateways to Italy, believing that new gateway service was an effective way to expand service and consumer choice in a regulated market. Similar considerations influenced our decisions to approve certain extra-bilateral services, such as authorizing Continental Airlines to enter the U.S.-Italy market pursuant to a codeshare arrangement with the Italian flag carrier, Alitalia.

It is in this context that six U.S. airlines now operate to Italy from five different U.S. gateways. Delta and TWA continue to serve Italy from New York, with each airline providing daily nonstop service to Milan and Rome. All of the other U.S. airlines serving Italy operate from their hubs.

Continental offers daily nonstop service to Rome and Milan from Newark. American offers daily Chicago-Milan service. United offers daily Washington, DC-Milan service. US Airways offers daily Philadelphia-Rome service.

The evidence is that these gateway operations have increased service, competition, geographical diversity and traffic growth in the U.S.-Italy market. They have made it possible for our airlines to provide a number of cities with new nonstop service to Italy and for these airlines to use their networks effectively to link the regions served by these networks to Italy. Traffic has responded dramatically to the new network services. Today, U.S. airlines transport about a half a million more annual passengers in the U.S.-Italy market than in 1990. That figure represents an increase of nearly 70 percent.

Against this background, the record supports a tentative finding that we can derive major public benefits from an award in this case by providing for new gateway services to Italy. This consideration strongly supports Delta's Atlanta-Rome application because only Delta would open a new gateway to Italy, and only Delta would permit the Southern region of the country to enjoy the benefits of U.S.-carrier gateway services. Delta would also provide the most significant behind gateway service benefits and enhance competition in the U.S.-Italy market. In these circumstances, we have tentatively determined that Delta's proposal offers the best use of the route authority at issue. While American and US Airways have submitted attractive proposals, their proposals do not match the public benefits that would be available under Delta's.

Primary Authority

Atlanta is the only gateway at issue in this proceeding that does not have nonstop service to Italy. It is also the largest airport in the country without nonstop service to Italy. Delta would remedy this deficiency by operating daily nonstop round-trip service between Rome and Atlanta with MD-11 aircraft, the largest aircraft proposed in this proceeding. In addition, Delta would provide Orlando with improved access to Italy by offering it dedicated change-of-gauge service via Delta's Atlanta hub.

The South is one region of this country that does not have its own U.S.-flag gateway to Italy. Delta would again remedy that situation by using its connecting complex at Atlanta to improve significantly air transportation between a large number of Southern communities and Italy. These are the type of significant public benefits that provide the cornerstone of our efforts to expand U.S.-carrier services in the U.S.-Italy market, and which are now being offered to other regions of the country, including those served by American's Chicago-Milan service and by US Airways' Philadelphia-Rome service.

Delta proposes single-carrier service to Italy for fifty-three southern cities. Delta expects to increase the convenience for almost 80,000 Southern-tier passengers traveling to Italy with its new Atlanta gateway service. DL-302 and DL-R-119. It will offer the first round-trip single-connection service to more than thirty Southern cities, and the first or first competitive round-trip service to more than forty Southern cities. DL-R-104 and 105. Delta's new gateway service will make it significantly easier and more convenient to travel between the Southern United States and Italy.

Delta would also provide significant service benefits to points outside of its core Southern tier service area. Delta's impressive Atlanta gateway hub will permit the airline to offer on-line connections to more than 100 cities, including round-trip single-connection service to more than eighty points. DL-113 and R-103. More than thirty-five cities will receive first round-trip single connection service, more than forty of cities will receive either first or first competitive round-trip single connection service to Rome, and about fifty-five cities will receive faster and more convenient service overall. DL-R-104, DL-R-105, and DL-R-107.

The selection of Atlanta as a new gateway to Italy should also increase competition in the U.S.-Italy market. Most of the U.S. airlines serving this market, as noted above, do so from one of their major hubs. These hubs allow them to collect traffic from points behind the gateway and flow that traffic to Italy over that gateway. All U.S. airlines in the market compete for at least a substantial portion of the same so-called behind gateway traffic. The selection of Atlanta as a new gateway to Italy will intensify intergateway competition in the market. The competitive impact of Delta's service from Atlanta should be strong, since the record shows that it is likely to attract a large number of behind gateway passengers, many of whom may now be using gateways served by Delta's competitors. For similar reasons, the selection of Atlanta as a new gateway should increase competition between Delta and foreign airlines serving other points, such as Miami.

American and US Airways have submitted competitive service proposals. Nonstop service by each airline should produce a relatively large number of passengers in its chosen gateway to Italy, as in the case of Delta's Atlanta-Rome operations. Chicago-Rome has the largest historic traffic base among the gateways at issue in this proceeding, having received nonstop service from Alitalia until late last year. American would restore that service with daily nonstop Chicago-Rome flights, and use its Chicago hub to provide extensive on-line service to Rome. It would offer sixty-five cities round-trip single-connection service—focusing on points in the Midwest and Western regions of the country, nineteen cities first round-trip single connection service, and twenty-six cities either first or first competitive round-trip single-connection service. AA-210, AA-220, and AA-221. US Airways would provide Philadelphia with its first daily nonstop round-trip flights to Milan, and use its Philadelphia hub to provide round-trip single-connection service to about the same number of cities as American, but first competitive round-trip single-connection service to fewer cities than American. US-126 and US-202. Overall, it is likely that American's Chicago service would benefit more passengers with online service than US Airways. Compare AA-310 to US-303.

Although the proposals of American and US Airways offer significant benefits, they would not, on balance, provide the much greater public benefits that are being offered by Delta's proposal. As to the local market, it is significant that Chicago and Philadelphia already benefit from nonstop service to Italy from American and US Airways. Therefore, while each airline would improve service from their chosen gateways to Italy, neither would offer first nonstop service to Italy from that point nor open a new gateway to Italy, as in the case of Delta's Atlanta-Rome proposal.

Delta's proposal also offers the greatest behind gateway service benefits that could result from an award in this case. Delta would significantly improve air service between the Southern region of the U.S. and Italy. Moreover, Delta would provide single connection service to the most cities; first round-trip single connection service to the most cities; and improve elapsed travel times for

the largest number of U.S. cities. Compare DL-120 to AA-310 and US-303. See also, DL-R-103, DL-R-105, and DL-R-107.

As to competition issues, American and US Airways each maintain that its proposal would provide the most significant competitive benefits in this case. Both carriers also argue that the selection of Delta would not foster a more competitive U.S.-Italy market structure, noting that Delta holds more U.S.-Italy authority than they, will be able to out schedule them even without the award of authority in this case, and can increase its Italy service while they cannot.

There is no question that the selection of either American or US Airways would also increase U.S.-Italy competition, and would have a positive impact on that market's structure. However, the selection of Atlanta as a new gateway to Italy would also enhance competition and, in addition, provide far more service benefits than the choice of any other gateway in this case, as previously discussed. Moreover, Atlanta's opponents in this case have overstated Delta's position in the market. Delta actually carried fewer U.S.-Italy passengers than TWA, and only slightly more than Continental, in 1997. Even assuming that Delta operates four daily frequencies in the Italy markets this summer, it will provide only thirty-five percent of the total U.S.-carrier U.S.-Italy frequencies and less than twenty percent of all service in the markets. In these circumstances, it is our tentative conclusion that to the extent that competitive considerations favor either American or US Airways, they do not outweigh the factors supporting Delta.

In reaching this tentative conclusion, we have carefully considered all other matters of record, including those relating to traffic forecasts, self-diversion, and unused authority.

Our analysis of the traffic forecasts in this case indicates that each applicant's estimate of the U.S.-Italy traffic it will carry contains a number of optimistic assumptions that may not occur. Nonetheless, we are confident that each applicant would have no difficulty implementing its service proposal, considering the strength of its chosen gateway, connecting hub, and the pent-up demand for additional U.S.-Italy service. As to Delta, we believe that arguments that its forecast is overstated are themselves overstated and have failed to show that Delta's proposal would not benefit the most U.S.-Italy passengers. On this point we note that the American and US Airways forecasts for Delta show that Delta would increase convenience for the most passengers in this case, even after substantial reductions were taken for alleged overstatements. AA-R-111 and US-R-310.

Some of Delta's opponents argue that it should be disqualified because it changed its service proposal and because it did not provide evidence of self-diversion.

Delta did not violate our rules by proposing to use a larger aircraft in its direct exhibits than it did in its initial application. All applicants are free to make revisions to their initial proposals in their direct exhibits as Delta did. All parties had a fair opportunity to respond to those revisions in their rebuttal exhibits.

We also believe that Delta should have submitted information relating to self-diversion, in order to develop the record on this. Those allegations include the contention that Delta should not be selected because the level of self-diversion resulting from its proposal would preclude it from

providing more new service benefits than the other applicants. However, there is enough information of record on the issue of self-diversion to allow us to reach a reasoned judgment about its impact on all the applicants. Delta would provide the most significant public benefits in this case, even taking self-diversion into account. Consequently, we cannot find that Delta's omission is material to our decision or otherwise warrants its disqualification from this case.

It is also argued that Delta should not receive an award in this case because, unlike the other applicants, it holds substantial unused U.S. –Italy authority. This argument refers to the fact that the bilateral permits, and the Department has authorized, Delta to operate nonstop service between a number of U.S. points following our approval of the Delta-Pan American World Airways route transfer. However, Atlanta is not among those points, and Delta is not otherwise authorized to operate Atlanta-Italy nonstop service. Furthermore, the evidence is that Delta operates only from the New York gateway because the other U.S. nonstop points named in its license cannot support nonstop service without substantial traffic support and because Delta's system operations cannot provide the level of feed traffic needed to provide that support. DL-T-1. In these circumstances, we agree with Delta that its unused authority is largely an anachronism and does not provide any grounds for denying the people of Atlanta and the Southern Region the enormous value of the service Delta has proposed in this case.

Back-up Authority

We have tentatively decided to award US Airways back-up authority in this case. US Airways urges us to use this proceeding to make broad market structure the primary selection criterion. Creating a more competitive international aviation market is one of our most important aviation objectives. We have relied on it to open aviation markets around the world. We also consider market structure issues in our regulatory proceedings, and in appropriate cases, give significant weight to this issue. Indeed, our decision to grant US Airways and Philadelphia nonstop authority to Italy was based, in part, on market structure considerations. However, the public benefits that are likely to result from providing Atlanta and the Southern region with opportunities that are comparable to those we provided Philadelphia and the Northeast region are compelling, and provide the selection of Delta with advantages that we tentatively conclude far outweigh those favoring the other applicants for the primary award in this case.

We strike the balance differently with respect to back-up authority. The choice between American and US Airways for back-up authority is much closer. Both applicants could step into the market quickly in the event that its back-up authority was activated, would improve service to Italy from an existing gateway, provide other significant service benefits and increase competition in the markets involved. It is likely that American would provide more significant on-line service benefits. However, we believe that the selection of US Airways' Philadelphia-Milan service would have greater impact on gateway competition and produce greater public benefits in the context of this case. As we emphasized earlier in this decision, the Department has a strong interest in enhancing gateway competition. We believe that we can achieve that important goal here by creating a new gateway to Italy, as in the case of Atlanta, and by providing as a backup a developing transatlantic gateway an additional opportunity to grow, as in the case of Philadelphia. On this issue, the record leaves no doubt that Philadelphia receives far less service to Italy and other transatlantic points. These considerations tip the balance in favor of US Airways for back-up authority to Italy.

ECONOMIC AUTHORITY

In the event we make final our tentative selection of Delta, we would grant Delta's application for a new certificate authorizing its proposed service in the U.S.-Italy market. As the Department set forth in the instituting order, we would issue Delta a five-year experimental certificate. Also, the frequency allocation would be of indefinite duration, but subject to the continued effectiveness of the holder's underlying certificate authority as well as to our standard condition that we may amend, modify or revoke the allocation at any time and without hearing, at our discretion. In addition, the frequencies allocated would be subject to our standard 90-day dormancy condition, wherein frequencies will be deemed dormant and will automatically revert to the Department for reallocation if they are not operated for 90 days, except where service in the market is seasonal. Finally, we would require Delta to institute service within 90 days of the date of service of a final order.

In the event we make final our tentative award of backup authority to US Airways, we would grant US Airways a backup certificate authorizing its proposed service in the U.S.-Italy market. The backup certificate would be effective for one year and would be activated if Delta does not institute or maintain service during that one-year period.

ACCORDINGLY,

1. We tentatively select Delta Air Lines, Inc., to provide scheduled foreign air transportation of persons, property, and mail in the Atlanta, Georgia-Rome, Italy, market beginning April 1, 1999.
2. We tentatively select US Airways, Inc., as a backup to Delta to provide scheduled foreign air transportation of persons, property, and mail in the Philadelphia, Pennsylvania-Milan, Italy, market should Delta not institute service;
3. We direct all persons to show cause why we should not issue an order making final our tentative findings and conclusions;
4. We direct interested persons wishing to comment on our findings and conclusions, or objecting to the issuance of the order described above, to file their comments or objections with the Department's Dockets, Docket OST-98-4854, U.S. Department of Transportation, 400 Seventh Street, SW, Room PL-401, Washington, D.C. 20590, no later than 10 calendar days from the date of service of this order; answers thereto shall be filed no later than 5 calendar days thereafter; ²
5. If no objections are filed, we shall deem all further procedural steps to have been waived, and will proceed to enter a final order subject to Presidential review under § 41307 Subtitle VII of Title 49, the United States Code (Transportation); and

² The original submission is to be unbound and without tabs on 8½" x 11" white paper using dark ink (not green) to facilitate use of the Department's docket imaging system. Submissions may also be sent using the Electronic Submission capability at the Dockets DMS web site, <http://dms.dot.gov>.

6. We grant the request of Tower Air, Inc., to withdraw its application for U.S.-Italy authority and frequency allocation in Docket OST-98-4854; and

7. We will serve this order on American Airlines, Inc.; Delta Air Lines, Inc.; Tower Air, Inc.; US Airways, Inc.; the City of Chicago; the City of Philadelphia (Division of Aviation); the Georgia and Atlanta parties; the Ambassador of Italy in Washington, D.C.; the U.S. Department of State (Office of Aviation Negotiations); and the Federal Aviation Administration (AFS-220).

By:

PATRICK V. MURPHY

Deputy Assistant Secretary for Aviation
and International Affairs

(SEAL)

*An electronic version of this document is available on the World Wide Web at
http://dms.dot.gov/reports/reports_aviation.asp*

**Summary of U.S.-Italy Proposals
Docket OST-98-4854**

Proposal Details	American	Delta	US Airways
U.S. Gateway	Chicago	Atlanta	Philadelphia
Italy Point	Rome	Rome	Milan
Aircraft	B767-323ER	MD-11	B767-200ER
Seats	204	269	203
Passenger Forecast	122,078	165,335	98,494 ³
Local	37,527	40,384	34,293
Connecting	84,551	124,951	64,201
Other Italy service	Chicago-Milan	New York (JFK)-Rome New York (JFK)-Milan	Philadelphia-Rome

³ US Airways also forecasts 4,459 Philadelphia-beyond Milan passengers and 5,725 behind Philadelphia–beyond Milan passengers, for a total of 108,678 passengers.